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C O N F I D E N T I A L SECTION 01 OF 02 TEGUCIGALPA 000135

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STATE FOR D, E, P, AND WHA
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TREASURY FOR AFAIBISHENKO
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SUBJECT: HONDURAN LEAD NEGOTIATOR ON FUEL IMPORTS SEES
TALKS AS POSITIVE AND PRODUCTIVE

REF: TEGU 0098 AND PREVIOUS

Classified By: AMB Charles Ford for reasons 1.4 (b,d)

¶1. (C/NF) Summary: In a January 22 meeting, Minister Enrique Flores Lanza seemed optimistic about the possibility of identifying changes to Honduras' fuel pricing formula that would avoid the pitfalls of nationalizing the sector or seizing assets, while still delivering politically necessary cost savings to the consumer. However, if such a reform to the formula is not adopted, the GOH remains ready to sign a sole-source contract with Conoco. Flores Lanza said that Conoco, however, seems less eager to sign such a deal, citing possible legal liabilities with the other IOCs. Arturo Corrales reports that Texaco has already made one suggestion for modifying the pricing formula, and that Esso has indicated its willingness to do so as well. Supporters of the nationalization strategy, meanwhile, have stridently attacked Corrales, the IOCs, and the USG. End summary.

¶2. (C/NF) Econoff spoke at length on January 22 to Minister Counselor for Legal Affairs Enrique Flores Lanza about the status and next steps for talks over fuel imports into Honduras. Flores Lanza was upbeat and relaxed, and characterized the recently held talks in Salvador as positive and productive. His recounting of the details closely matched that supplied separately to EconChief (reftel) by Arturo Corrales, advisor to President Jose Manuel "Mel" Zelaya Rosales on the fuels negotiation and a participant in those talks. Flores Lanza clearly accepted the GOH analysis that the proposed sole-supplier contract with U.S. firm ConocoPhillips would not save Honduras much money. He seemed optimistic that reasonable proposals would come in this week from the international oil companies (IOCs) already active in Honduras regarding how to reform the pricing formula and liberalize the sector, instead of moving to a sole-source contract. Flores Lanza said the GOH will need to take "mature decisions" on the matter "within the next two weeks."

¶3. (C/NF) Regarding the ConocoPhillips bid, Flores Lanza said that the contract has not been signed, and talks were

scheduled to continue this week, but that Conoco has not yet confirmed it will be sending a delegation. According to Flores Lanza, Conoco has growing concerns about signing the contract, based on a meeting with USTR in which they were allegedly warned that such a contract could lead to legal challenges from other U.S. firms. In Flores Lanza's view, either the meeting did happen, in which case Conoco has legitimate concerns, or it did not, in which case "Conoco is laying the groundwork for possibly walking away from the deal." Post has no information about the alleged meeting, but told Flores Lanza that each company would need to decide for itself whether to initiate a legal challenge, and that Conoco's concerns about being pulled into such a lawsuit could not be discounted. In any case, EconChief stressed, Conoco is a world-class company and Post has complete faith that Conoco would deliver on any contractual obligation. That said, Conoco and the GOH have not yet concluded negotiations and until a contract is signed either side could freely decide not to pursue the deal.

¶4. (C/NF) Asked if the GOH still sought a contract with Conoco, Flores Lanza replied that the GOH "could never say it was not seeking a deal with Conoco. However, we can choose to be more flexible or less flexible in the negotiations." Flores Lanza said that if the GOH can find a better alternative to nationalizing the sector and signing a sole-source contract with Conoco, it will be less flexible in its talks with Conoco. Should they have no alternatives, however, they will need to be very flexible with Conoco. (Comment: With little savings from the nationalization scheme and the threat of possible legal repercussions in the future, it appears that for political reasons the GOH is increasingly searching for an alternative exit strategy. That said, if

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they cannot find a way out that gives them the political victory they seek, they remain willing, if perhaps not eager, to sign a contract with Conoco. End Comment.)

¶5. (C/NF) On January 22, EconChief also spoke with Arturo Corrales, who said that Texaco had presented a plan to the GOH to restructure the pricing formula and that it's numbers were "very, very close" to what the GOH had proposed in the Salvador meetings. Esso has not yet presented suggested modifications, but reportedly told Corrales that "a bad deal is still better than a good lawsuit."

¶6. (C/NF) In the meantime, the more radical elements of the Patriotic Coalition (the group that most ardently supports the scheme to nationalize imports) have denounced the GOH talks with the IOCs and called for immediate ratification of the contract with Conoco. They were incensed that a coalition member was not sent to Salvador to witness the talks. (Comment: This group has no interest in negotiating a workable deal, and will accept nothing less than full state control of imports. Their presence at the negotiations would have doomed them to failure. Zelaya's decision to exclude them, while controversial, was a bold move, and the right one. End Comment.) Patriotic Coalition president Juliette Handal has gone on the offensive, alleging that special interests are manipulating the process, and that the USG is pressuring Conoco to not sign the contract. (Comment: To Post's knowledge, no element of the USG, either here or in Washington, has ever discouraged either Conoco or the GOH from signing such a contract. We have, however, reminded the GOH that the implementation of such a contract cannot infringe upon the rights of other investors. End Comment.)

¶7. (C/NF) Corrales was invited to debate Handal at the Honduran chamber of private enterprise (COHEP) on January 24. Corrales enthusiastically accepted; Handal rejected the invitation and publicly excoriated Corrales, the GOH, the IOCs, and the USG. Because Handal refuses to appear, Corrales will decline the offer for now, because he agrees with Flores Lanza that it would be best to turn down the heat on the public debate of this issue while sensitive talks with

both the IOCs and Conoco are still ongoing.

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